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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 72

STATE OF WISCONSIN AND PUBLIC SERVICE COMMISSION OF WISCONSIN, AND PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PETITIONERS

v.

FEDERAL POWER COMMISSION, PHILLIPS PETROLEUM CO.

No. 73

PEOPLE OF THE STATE OF CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, PETITIONERS

v.

FEDERAL POWER COMMISSION, PHILLIPS PETROLEUM CO.

No. 74

LONG ISLAND LIGHTING COMPANY, PHILADELPHIA ELECTRIC COMPANY, AND THE UNITED GAS IMPROVEMENT COMPANY, PETITIONERS

v.

FEDERAL POWER COMMISSION, PHILLIPS PETROLEUM CO.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION

OPINIONS BELOW

The opinion of the court of appeals (R. 410) is reported at 303 F. 2d 380. The orders of the Federal

Power Commission terminating proceedings (R. 251) and denying rehearing (R. 395) are reported at 24 F.P.C. 537 and 1008, respectively. The presiding examiner's decision (printed in part at R. 35) is reported at 24 F.P.C. 590.

JURISDICTION

The judgment of the court of appeals was entered on November 30, 1961 (R. 431–432). Petitions for writs of certiorari were granted on May 14, 1962 (R. 432–434), 369 U.S. 870. The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Whether the Commission, in a proceeding initiated under Section 5(a) of the Natural Gas Act to establish the future rates of an independent producer of natural gas, was required to use the individual company cost-of-service approach to rate making, despite its conclusion that the method is unworkable as applied to producers.

2. Whether the Commission, having found that the producer's cost of service for the test year substantially exceeded its revenues (including those generated by the increases in issue), properly concluded that no refunds were due under Section 4(e) for past ("locked-in") periods.

3. Whether the Commission erred in failing to reject certain proposed rate increases based on spiral escalation clauses.

STATUTES INVOLVED

The pertinent statutes, Section 4(e), 15 U.S.C. 717c(e) and Section 5(a), 15 U.S.C. 717d(a) of the Natural Gas Act, are set forth in Appendix A, *infra*, pp. 65–66.

STATEMENT

The order here under review is a sequel to this Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672. The Court there affirmed the decision of the court of appeals,[1] which set aside a Commission order holding that it lacked jurisdiction over the rates of Phillips Petroleum Co., an independent producer of natural gas. On remand, the Commission, on November 22, 1954, reinstituted its investigation of Phillips' rates under Section 5(a) of the Natural Gas Act.[2] That section empowers the Commission, either upon its own initiative or upon complaint, to conduct a hearing with respect to the rates of any natural gas company and—if it finds those rates to be unjust, unreasonable, unduly discriminatory, or preferential—to determine prospectively the just and reasonable rates to be thereafter in force.

Later, the Commission consolidated with this Section 5(a) docket (No. G–1148) twelve other proceedings under Section 4(e)[3] of the Act resulting from the Commission's suspension of increased rates filed by Phillips. Under Section 4(e), a proposed increased rate filed by a natural gas company may be suspended

[1] *Wisconsin* v. *Federal Power Commission*, 205 F. 2d 706 (C.A.D.C.).

[2] 52 Stat. 823, 15 U.S.C. 717d(a), Appendix A, *infra*, p. 66.

[3] 52 Stat. 822, 15 U.S.C. 717c(e), Appendix A, *infra*, pp. 65–66.

by the Commission for a maximum period of five months; if the Commission has not by that time determined the issue of justness and reasonableness, the rate may nonetheless be put into effect, but in that event the proponent may be placed under a duty to refund such portion of the amounts collected as the Commission may later find unjustified. All of the suspended rates in the present case (with the minor exception of Docket No. G–8623, involving an annual increase of only $23,324) have been superseded by later filings, which in turn were suspended in other proceedings not here involved. In other words, the Section 4(e) proceedings involved in this case do not concern rates which were currently in effect as of the date of the Commission's decision, but relate to so-called "locked-in" periods—*i.e.*, periods which commenced on the effective date of the rate increase at issue and ended on the effective date of a subsequent and superseding rate increase. Thus, on this aspect of the case, only refunds are in issue.

The hearings in the consolidated proceedings began on June 26, 1956, and ended on December 18, 1957, consuming a total of 82 hearing days. Thirty-one parties intervened, including the petitioners in the three cases now before this Court.[4] The record ran to some 27,000 pages. Extensive briefing followed, the last reply brief being filed on May 5, 1958. On

[4] Petitioners in No. 74 are collectively referred to as the Eastern Seaboard Companies.

April 6, 1959, the examiner's decision, over 300 pages in length, was handed down.[5]

The Examiner's Decision.—The examiner found that in the test year, 1954, Phillips sold more than 588 million Mcf of natural gas, of which 491 million, or 71.3%, were sold for resale in interstate commerce. Its own production in that year was over 375 million Mcf, of which more than 226 million was "dry gas" (also sometimes called "gas-well gas"), and the remaining 149 million was produced together with oil. It purchased 408 million Mcf from other producers[6] (R. 74, 340).

The annual rate increases involved in the Section 4(e) proceedings consolidated in these hearings amounted to $5¼ million. The proposed increases were to levels ranging between 5.5¢ per Mcf and 13.5¢ per Mcf, except for one increase to 17¢ per Mcf (R. 75). Increases suspended subsequent to December 14, 1956, were not consolidated and are not part of this case.

These hearings proceeded, and the entire record was compiled, on the assumption that Phillips' cost of service for the test year, 1954, was the appropriate yardstick for prescribing its rates. Several studies were put in evidence purporting to show Phillips' total cost of service for that year (*i.e.*, all operating expenses, including depreciation, depletion, and taxes,

[5] 24 F.P.C. 590; R. 35. (The examiner's decision is not reproduced in full in the joint appendix.)

[6] The difference between the total volume sold and the larger amount produced and purchased consists of company uses, residue returned to leases, etc.

plus a fair return on net investment). The results of these studies (R. 93), together with the examiner's findings (R. 212), are shown by the following table:

	Total	Per Mcf (cents
Phillips	$92,309,438	18.793
F.P.C. Staff	42,024,180	8.55
Eastern Seaboard Companies:		
At 9% rate of return	55,046,180	11.207
At 12% rate of return	60,489,481	12.315
Wisconsin	48,647,832	9.904
Examiner	57,280,218	11.662

The examiner's figure of $57,280,218 for cost of service was some $14 million *above* Phillips' actual test year revenues prior to the filing of the rate increases in the Section 4(e) proceedings involved here—increases providing $5¼ million in additional revenues. He ordered Phillips to calculate a rate which, applied to the 1954 volumes, would produce revenues substantially equal to the cost of service (R. 214) he had determined. This rate, with appropriate adjustments for quality, pressure, delivery point, etc., would then be applied to all rate schedules in effect at the time of approval by the Commission. That is, future rates from 1959 on were to be based on the 1954 cost of service.

The examiner noted (R. 212):

> * * * The aggregate increase of $14 million annually, resulting from this decision, would be roughly $8¾ million higher than the $5¼ million increase reflected in Phillips' consolidated Sec. 4(e) dockets—which the interveners have here expressed their willingness to accept.

The Commission's Opinion.—It was not until its receipt of the examiner's report that the Commission

had its first opportunity to examine fully a major contested case in which an attempt had been made to develop just and reasonable rates for an independent producer of natural gas.[7] On September 28, 1960, it issued Opinion No. 338 (R. 251), the subject of this appeal. In the Commission's view, the most important question before it was whether the individual company cost-of-service method should be applied in this proceeding at all (R. 254). It is the Commission's decision on that point which gives rise to most of the petitioners' objections.

The Commission concluded (R. 256), in the light of its experience in this and other cases during the previous five years, that the original-cost, prudent-investment, rate-base method which had been used in the regulation of electric utilities and natural gas pipelines was not a workable method for purposes of fixing the rates of independent producers of natural gas. It declared that the ultimate solution of the problem of producer regulation lies in the determination of fair prices for the commodity, based on the reasonable financial requirements of the industry in each production area, and not on the investment and expenses of each individual natural gas company.

In addition to its general objections to the use of the individual company cost-of-service method, the Commission noted a serious infirmity in the particular record before it, *i.e.*, the fact that it was based on a

[7] A number of minor cases, involving slender records, relatively few sales, and little or no attempt to face the basic problems raised here, are cited in footnotes 8 and 9 of the Commission's opinion (R. 264).

six year-old test year, 1954. It observed, on the basis of its knowledge of conditions in the industry, that costs and prices of gas in the field had greatly increased since 1954 and concluded that to require the company to file decreases in rates in 1960 based on so remote a test year would be "a result without reason or justice." R. 324–325. Accordingly, concluding that it was inappropriate to prescribe rates for the future on the basis of the present record, the Commission terminated the Section 5(a) rate investigation in the original docket, No. G–1148.

However, inasmuch as the evidence in this case had been presented solely on a cost-of-service basis, the Commission, despite its fundamental disapproval of that method, computed a company-wide cost of service for the 1954 test year and utilized it to dispose of the Section 4(e) proceedings. It arrived at a cost of service of $54,525,315, or 11.1009¢ per Mcf, subject to adjustments for purchased gas costs, gathering taxes and royalties (R. 401).[8] This figure, it found, substantially exceeded the test-year jurisdictional revenues of $45,568,291 (R. 326). The Commission further found that the increased rates involved in the Section 4(e) dockets had produced revenues less than Phillips' cost of service during the periods that they

[8] That is to say, if Phillips' rates were to be raised to cover cost of service, these three cost items would increase to above the levels at which they are included in the cost of service figure given. The reason for this is that these costs fluctuate with rates. The Eastern Seaboard Companies pointed out in their brief below that this suggests a total revenue requirement, after adjustments, of $59,725,315, or a unit cost of 12.16¢ per Mcf.

were in effect. It also noted that the record failed to indicate that any of those rates were unduly discriminatory or preferential. Consequently, the Commission decided that no refunds should be required in any of the Section 4(e) cases and, so finding, terminated all but two of those cases.

The two Section 4(e) proceedings not terminated were kept open pending determination of the effect of "spiral escalation" clauses in Phillips' contracts.[9] In one of these dockets, No. G–11217, Phillips had filed an increase under a spiral escalation clause which it contended was activated by a rate increase filed by El Paso Natural Gas Co. in Docket No. G–4769,[10] 22 F.P.C. 260. El Paso argued that the spiral escalation clause was not activated and provided no basis for Phillips' rate increase in Docket No. G–11217. The Commission held (R. 328) that if the amount of escalation determined to be allowable in G–4769 turns out to be less than the increase proposed in Docket No. G–11217, the excess portion would be a unilateral increase barred by the *Mobile* doctrine, *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, and would have to be refunded. The other docket,

[9] Such clauses provide that when a specified commodity price index increases by more than a prescribed number of points, and a general increase in the pipeline's resale rates has gone into effect, then Phillips' rates to the customer may be proportionately increased (R. 327).

[10] El Paso's rates in G–4769 were allowed to become effective April 15, 1955, but, following court review, are again before the Commmission on remand. *El Paso Natural Gas Co.* v. *F.P.C.*, 281 F. 2d 567 (C.A. 5), certiorari denied, *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912.

No. G–10883, was left open because of similar considerations with respect to increases filed by Panhandle Eastern Pipeline Co. in Docket No. G–2506. If the rates finally approved in G–2506 are insufficient to justify Phillips' proposed increases in G–10883, a refund will be necessary (R. 328–329).

Simultaneously with its opinion in this case, the Commission issued its Statement of General Policy 61–1 (R. 343), setting forth two sets of ceiling prices for natural gas in each of the country's major producing areas. New sales at higher prices would not be certificated, the Commission announced, without a justification of the proposed price. Moreover, proposed price increases (on gas already certificated for sale) to prices above those prescribed would be suspended under Section 4(e) and then permitted to go into effect only subject to refund. The Commission also announced that it would begin a series of comprehensive rate hearings, each designed to cover a major producing area and to establish just and reasonable rates for all producers in that area.

The Decision Below.—The court of appeals affirmed, Judge Fahy dissenting in part. The opinion points out (R. 417) that the rates in issue are not rates of conventional public utilities, such as pipelines, but, rather, are charges for a processed commodity which varies widely in physical quality, points and terms of delivery and other factors, and that such charges involve "hundreds of producers, hundreds of contracts, and thousands of rate filings." No one, said the court (R. 418), contends that a cost of service could be

meaningfully determined for each contract, *i.e.*, for each Section 4(e) proceeding. The court held that in dealing with the Section 4(e) proceedings the Commission decided "[t]he only question of substance," *i.e.*, whether there should be refunds (R. 419). Having determined that Phillips' revenues in the test year fell short of its cost of service by $9 million, and that the increases involved in the Section 4(e) proceedings were far less than needed to wipe out that deficit, the Commission, in the court's opinion, reasonably concluded that no refunds were due (R. 420–421). It terminated those proceedings, but only "after deciding the basic and dispositive issue" before it (R. 420).

Noting with approval the Commission's adoption of interim controls (by its Policy Statement) and its initiation of area rate proceedings (now in progress), the court sustained the termination of the Section 5(a) proceeding on the ground that the Commission had ample authority to fashion new regulatory standards and to abandon those found unsatisfactory and unworkable (R. 421). The court also rejected as unfounded the charge that the Commission "has abandoned regulation of these rates for this interim period" (R. 425).

Judge Fahy agreed (R. 427) that the Commission's "[e]mbarkation upon the area method * * * does not necessitate judicial intervention, certainly not at this time." He was of the view, however, that, having conducted the evidentiary proceeding on the assumption that the cost-of-service method would be utilized, the Commission should proceed further upon that

basis in this case, "though it may need to update the record" (*ibid.*).

SUMMARY OF ARGUMENT

1. The Natural Gas Act does not require the Commission to use any particular rate-making formula. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 600–601. On the contrary, many decisions of this and other courts make clear that the selection of an appropriate regulatory method is a matter which lies within the sound discretion of the Commission. No court has even intimated that the individual company cost-of-service technique must be employed in regulating the rates of independent producers.

In the instant case, the record was made on the assumption that Phillips' estimated cost of service would determine its rates. After careful examination of this record (the first to come before it in a major independent producer case) the Commission decided, for sound and clearly articulated reasons, that the traditional company-by-company cost method did not assure meaningful results when applied to independent producers of natural gas. It pointed out, among other things, that the stable relationship between input (investment) and output (service) which characterizes pipelines and conventional public utilities, and which justifies computing return (*i.e.*, profits) on the basis of investment, is almost entirely lacking in the case of independent producers. It observed that to use the costs of each individual company as the yardstick for determining its rates would reward the inefficient and penalize the efficient, invite royalty owners to lease

their properties to the highest-cost producers, give rise to cost allocation problems (as between oil and gas) of unparalleled difficulty and of inordinate weight in the final rate determination, and involve the intolerable administrative burden of repeated and complex rate cases for each of several thousand independent producers.

Section 5(a) authorizes the Commission to prescribe rates for the future only if it finds existing rates to be unjust and unreasonable. Here the Commission reasonably decided that the record before it, premised entirely on rate-making assumptions of dubious applicability, made this finding inappropriate. Moreover, even if the rate-base method, despite its severe limitations as a permanent regulatory tool, could be made to do temporary duty, it was still plain to the Commission that Phillips' rates for 1960 and future years could not fairly be fixed on the basis of a stale (1954) test year. Thus, the Commission was faced with a choice between two courses: On the one hand, it could assign its limited personnel the task of compiling a new cost-of-service record in order that Phillips' rates might be fixed by the method already found wanting. On the other hand, it could devote its energies and those of its staff to the development of a new approach—the area-rate approach—which alone, in its view, held out the prospect of sound and comprehensive regulation of producer rates. The Commission did not abuse its discretion in adopting the latter course.

This does not mean, as petitioners suggest, that the Commission has abandoned the regulation of producer

rates during the interim period required for the establishment of definitive area rates. Its termination of the Section 5(a) proceeding here was accompanied by the issuance of a Statement of General Policy, designating interim ceiling prices for each major producing area. These mark the point at which the Commission refuses to grant certificates for initial sales and suspends proposed rate increases under existing contracts. Through this and a combination of other measures the Commission has now succeeded in halting the upward trend in natural gas prices which prevailed for many years, and in numerous instances has secured lower current rates, substantial refunds, and assurances of future price stability. The preference of these petitioners for a particular method of rate-making should not be permitted to obscure the substantial accomplishments of the Commission in the past two years or the substantial promise of the area-rate approach.

Area rate proceedings are well under way in two major producing areas, the Permian Basin of Texas and South Louisiana. If these proceedings are permitted to go forward without interruption or slackening, determinations governing a substantial portion of Phillips' sales *and sales of most other major producers as well* may be available within roughly the same period of time that would be required to complete a Section 5(a) proceeding covering Phillips alone. However, a decision compelling the Commission to bring the records up to date in this case and in other outstanding Section 5(a) proceedings involv-

ing individual companies would necessarily tend to delay the area rate program.

It is clear that the Commission cannot effectively pursue both objectives at the same time. It cannot make optimum progress in establishing area rates if simultaneously it must also establish individual company rates according to the rate-base technique it has found wanting. It cannot fix rates for the industry as a whole if it must continue, company by company, to undertake the kind of proceeding to which the Court referred when it noted that "* * * the delay incident to determination in § 5 proceedings * * * appears nigh interminable." *Atlantic Refining Co. v. P.S.C. of New York*, 360 U.S. 378, 389. Granting that there are problems of transition, it should not be compelled to expend its necessarily limited capacities in travelling two divergent roads leading to inconsistent ends.

2. The Section 4(e) proceedings involved in this case relate to increased rates which were in effect during past periods, but had been superseded by subsequent filings (which in turn became the subject of other Commission proceedings). The increases here, therefore, have no current or future application. The only question as to these rates was whether the Commission had basis for ordering refunds of amounts collected during the past periods in question. The Commission found (and petitioners do not dispute) that in the 1954 test year Phillips' cost of service substantially exceeded its revenues and that the increased rates under review were not sufficient to close this gap. In these circumstances, termination of the Section 4(e) proceedings was plainly justified.

3. In No. 73, California objects to the Commission's refusal, in three dockets, to outlaw "spiral escalation" clauses, *i.e.*, clauses in Phillips' contracts which provide for increases in its rates when the rates of its customer, the pipeline, have risen. (Wisconsin, which raised a similar argument below, has abandoned it here.) As to two of the three dockets to which California's objection relates, its claim is premature because no final order has been entered; as to the third docket, California is not aggrieved because the sales in question do not pertain to gas destined for that State.

In any event, the objection is groundless. In essence, the contention is that the Commission should have declared spiral escalation clauses contrary to the public interest and void *ab initio*, in which case the rate increases filed pursuant to them would not have been contractually authorized and would thus have to be rejected regardless of their relationship to the company's costs. See *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 335. In the absence of any statute, common-law rule or administrative regulation condemning spiral clauses, the Commission was not required to nullify them as a matter of law. The courts have given effect to such clauses. Indeed, this Court has upheld the right of a seller to file for rate increases under a contract which, in effect, gave unlimited authorization for such filings and therefore went well beyond the escalation clauses here. And, although the Commission has in the last two years issued orders banning spiral clauses for the future, it

was surely under no compulsion (assuming it had the power to do so) to make those orders retroactive.

ARGUMENT

I

THE COMMISSION WAS NOT REQUIRED TO FIX PHILLIPS' RATES FOR THE FUTURE BY USING THE INDIVIDUAL COMPANY COST-OF-SERVICE METHOD

A. THE NATURAL GAS ACT DOES NOT REQUIRE THE USE OF A PARTICULAR METHOD OF RATE-MAKING

Although all of the petitioners maintain that the Commission must continue to use the "established" method of price determination on an interim basis until an alternative approach has been fully developed, only California takes the position that the Commission lacks power, in the long run, to abandon that method as a permanent tool for regulating the rates of independent producers. It argues that the existing formula is "a lawful, established and effective method of determining just and reasonable rates, and for these reasons must not be abandoned" (No. 73, Br. 36 *et seq.*). In the light of California's contention, it is important to establish at the outset that neither Congress nor the courts have ever undertaken to prescribe the rate-making formula which must be used in regulating pipelines or independent producers, but, instead, have accorded the Commission broad discretion to select the method it deems appropriate.

The debate between exponents of the individual company cost-of-service method, on the one hand, and of the "commodity value" or area-rate approach, on the other hand, is of relatively recent vintage. But

the broader question whether the Commission is bound to the use of a particular rate-making formula first arose in the course of controversy as to whether the agency was obliged to allow a pipeline a return on the "fair value" or "replacement cost new" of its properties (the traditional method under *Smyth* v. *Ames*, 169 U.S. 466) or was free to adopt a new method whereby the return was computed on the prudent investment in the pipeline's properties and facilities (plus working capital and minus accrued depreciation). That issue was resolved by this Court in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, which upheld the power of the Commission to fix rates by the then unorthodox prudent investment rate-base method.

Petitioners would have it that the unorthodoxy of one generation of Commissioners fixed an inviolable dogma for the next. It is the method which the Court permitted in *Hope—i.e.*, the individual company cost-of-service method, employing a prudent investment rate base—which all of the petitioners now characterize as the "established" method and which they insist must be applied (either permanently or temporarily) to the novel task of regulating the prices of independent producers. In *Hope*, however, this Court took pains to avoid any suggestion of such a limitation (320 U.S. at pp. 600-601):

> * * * Congress, however, has provided no formula by which the "just and reasonable" rate is to be determined. It has not filled in the details of the general prescription of § 4(a) and § 5(a). It has not expressed in a specific

> rule the fixed principle of "just and reasonable".

After rejecting the "fair value" contentions,[11] the Court, citing *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, went on (320 U.S. at p. 602) to state its holding in terms which preclude fastening upon the Commission any specific method of rate making:

> We held in *Federal Power Commission* v. *Natural Gas Pipeline Co., supra*, that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of "pragmatic adjustments." *Id.*, p. 586. And when the Commission's order is challenged in the courts, the question is whether that order "viewed in its entirety" meets the requirements of the Act. *Id.*, p. 586. Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling.

The refusal of the Court to adopt or approve the cost-of-service method as such, though upholding rates fixed by that method, was particularly significant in light of the fact that the Power Commission in *Hope* sought to have its order sustained by arguing that, although the cost-of-service method had not been expressly written into the statute, Congress intended cost of service to be used insofar as constitutionally

[11] Contentions based on the "fair value" rule were rejected on the elemental ground (320 U.S. at p. 601) that "rates cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings under whatever rates may be anticipated."

possible.[12] In short, the *Hope* decision rejected the substance of the very contention now advanced by petitioners.[13]

Later, in *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, which was addressed to the question whether the Commission had power to include the producing properties of an interstate pipeline in its rate base, the Court, answering this question affirmatively, suggested that the Commission would not be precluded from using an area-price approach ("Some have thought that to be the wiser course." *Id.* at 601) in lieu of the rate-base method.

The courts of appeals have similarly refrained from reading into the Acts a mandate to use the original-cost, rate-base formula. *Panhandle Eastern Pipe*

[12] *Federal Power Commission, et al.* v. *Hope Natural Gas Company*, S. Ct. No. 34, October Term, 1943, Brief for Petitioners, pp. 36–39.

[13] It is noteworthy that, while the Federal Power Act, 49 Stat. 838, 16 U.S.C. 791a–825r (upon which the Natural Gas Act was modeled) was under consideration in Congress, this Court's reaffirmance in *West* v. *Chesapeake & Potomac Tel. Co.*, 295 U.S. 662 (1935), of the *Smyth* v. *Ames* fair-value rule, gave rise to such grave doubts as to the constitutionality of the original-cost rate-base formula that the House Committee deleted (H. Rep. No. 1318, 74th Cong., 1st Sess., p. 30) a provision in the bill as it had been passed by the Senate which would have provided that in determining just and reasonable rates, the Commission shall fix a rate base "not in excess of the actual legitimate cost of the property." S. 2796, Section 208(c), 79 Cong. Rec. 9065; see also S. Rep. No. 621, 74th Cong., 1st Sess., pp. 20, 40. It is clear, therefore, that the original-cost rate-base method, which petitioners characterized as "traditional" and "conventional" was not written by Congress into either the Federal Power Act in 1935 or the Natural Gas Act in 1938.

Line Co. v. *Federal Power Commission*, 143 F. 2d 488, 491–494 (C.A. 8), affirmed, 324 U.S. 635; *Cities Service Gas Co.* v. *Federal Power Commission*, 155 F. 2d 694, 698–699 (C.A. 10), certiorari denied, 329 U.S. 773; *Interstate Natural Gas Co.* v. *Federal Power Commission*, 156 F. 2d 949, 951 (C.A. 5), affirmed, 331 U.S. 682; *Pennsylvania Water & Power Co.* v. *Federal Power Commission*, 193 F. 2d 230, 241–243 (C.A.D.C.), affirmed, 343 U.S. 414.

Notwithstanding the clarity of these rulings, the decision of the Court of Appeals for the District of Columbia Circuit in *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (C.A.D.C.), certiorari denied, 352 U.S. 829, gave rise to temporary uncertainties. In that case, upon which petitioners rely heavily (No. 72, Br. 32–33; No. 73, Br. 25; No. 74, Br. 31), the court, in considering the price which a pipeline could charge its ratepayers for gas produced from its own wells, stated (230 F. 2d at p. 818):

> [Cost of service] has been repeatedly used by the Commission, and repeatedly approved by the courts, as a means of arriving at lawful—'just and reasonable'—rates under the Act. *Unless it is continued to be used at least as a point of departure,* the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognizable meaning. [Emphasis supplied.]

Significantly, however, the court expressly refused to place its decision on the ground urged by petitioners in that case, *i.e.*, that "only a traditional rate-base

method can lead to 'just and reasonable' rates, or in any event, on the ground that the field price method cannot do so" (230 F. 2d at p. 814). Instead, it stated (*id.* at 815):

> * * * the allowance of a field price for the utility's own produced gas as an element in the ultimate composition of rates is not unlawful merely because it departs from the traditional rate-base method. * * *

All the court held in *City of Detroit* is that where the Commission adopts the cost-of-service method to fix rates of a pipeline, but then, instead of consistently following that method, uses another method which allows a higher return on the gas production part of the company's operations (230 F. 2d at 818):

> * * * the evidence and findings must show that the increase in rates thus caused is no more than is reasonably necessary for the purposes advanced for [the] increase. Since there is nothing in these proceedings from which such a conclusion could be drawn, they are fatally defective. * * *

Cf. *Mississippi River Fuel Corp.* v. *Federal Power Commission,* 163 F. 2d 433, 443 (C.A.D.C.).

City of Detroit was followed by a series of decisions in the District of Columbia and Fifth Circuits, in which the courts upheld Commission orders denying rate increases to independent producers on the ground that they could not justify such increases merely by showing that the proposed rates were comparable to the going price in the field. *Bel Oil Corp.* v. *Federal Power Commission,* 255 F. 2d 548

(C.A. 5), certiorari denied, 358 U.S. 804; *Forest Oil Corp.* v. *Federal Power Commission*, 263 F. 2d 622 (C.A. 5); *Episcopal Theological Seminary* v. *Federal Power Commission*, 269 F. 2d 228 (C.A.D.C.), certiorari denied *sub nom. Pan American Petroleum Corp.* v. *Federal Power Commission*, 361 U.S. 895.[14] But in sustaining the Commission's judgment that the limited evidence which had been offered to justify a field-price approach was not sufficient to show that the rates proposed were "just and reasonable", the courts did not rule that the individual company cost-of-service approach had to be used. On the contrary, the opinions make unmistakably clear that the choice of the method of fixing independent producer rates was the Commission's responsibility.

Thus, in *Bel Oil*, the first case, the Fifth Circuit declared (255 F. 2d 548, 553–554):

> The regulation of the prices at which thousands of "natural gas companies" may sell to the pipeline companies is a difficult one at its best. It is a field which in many respects re-

[14] The opinion of the Court of Appeals for the District of Columbia Circuit was written by Mr. Justice Reed, retired, sitting by designation. It is informative to note that the same Justice, sitting similarly in a pipeline rate case where a formula used by the Power Commission was under attack, pointed out (*Battle Creek Gas Co.* v. *Federal Power Commission*, 281 F. 2d 42, 46 (C.A.D.C.)): "The role of reviewing courts in passing on the rate-making methods used by administrative agencies is necessarily narrow. * * *" and in support cited the *Natural Gas Pipeline*, *Hope* and *Colorado Interstate* cases, *supra*, and the dissenting opinions in those cases (including one of his own), which would have construed the Gas Act as leaving the Commission a narrower authority to choose rate-fixing methods than the Court's majority decisions actually did.

> quires new formulas to test what is just and reasonable. * * *

In *Forest Oil, supra,* the same court took pains to emphasize that the Commission was not compelled to use any particular formula (263 F. 2d at 626):

> We do not think that either the Commission or the petitioner should be baffled or handicapped in this new field of regulation by any formulas by whatever name they are known. Specifically, if there is an accounting or rate-making formula known to the public utilities industry as a "conventional rate-base method of rate-making" which the Commission in its order of dismissal in this case said must be used at least as a basis of comparison or point of departure, we say the Commission need not require it unless such method is the only way by which the Commission can make its required determination. * * *

Finally, in *Minneapolis Gas Co.* v. *Federal Power Commission,* 294 F. 2d 212 (C.A.D.C.), the District of Columbia Circuit, endorsing the attitude expressed by the Fifth Circuit in the above case, rejected the contention that, in order to determine the justness and reasonableness of producer rates, the Commission is compelled to enter upon a full blown cost-of-service inquiry (294 F. 2d at 216–217):

> * * * Whether in a particular case rate-base proof is necessary is something which the Commission must in the first instance decide, in the light of the statute and the relevant cases. * * * [A]s the Supreme Court has made clear, there are many cases in which rate-base proof is unnecessary. [Citing *Hope, supra.*] In this re-

> gard we note our agreement with the attitude taken by the Fifth Circuit with reference to problems such as those raised in the instant case [citing the *Forest* and *Bel Oil* cases, *supra*]. It may well be that on the record ultimately made before it the Commission will decide that a cost-of-service-rate-base inquiry is not necessary. * * *

Thus, the recent round of independent producer cases has reaffirmed the principle, early established by this Court in *Hope*, that the choice of the appropriate method for determining just and reasonable rates lies within the sound discretion of the Commission.

B. THE COMMISSION HAD SOUND REASONS FOR CONCLUDING THAT THE RATES OF INDIVIDUAL PRODUCERS COULD NOT BE EFFECTIVELY REGULATED ON A COMPANY-BY-COMPANY BASIS

Experience in this case, as well as other rate proceedings, convinced the Commission that the traditional method of regulating public utilities was not "a sensible, or even a workable, method of fixing the rates of independent producers of natural gas" (R. 256). The reasons articulated by the Commission in its opinion (R. 256–269) amply support that conclusion.

The heart of the matter, as the Commission recognized (R. 257), is that, in the case of public utilities, there is usually a close correlation between the amount of money invested in facilities and the amount of service rendered to the public, and it is therefore appropriate to reward utilities in proportion to their respective investments; no predictable correlation obtains, however, between the investment input and the

marketable output of the natural gas producer. One producer, without the slightest imprudence, might invest large sums in exploration and find relatively little gas, while another might discover a bonanza with his first well. The implications of this fact for regulatory purposes were discerned with extraordinary insight by Mr. Justice Jackson in the *Hope* case, *supra*, 320 U.S. at 649 (dissenting opinion):

> The prudent investment theory has relative merits in fixing rates for a utility which creates its service merely by its investment. The amount and quality of service rendered by the usual utility will, at least roughly, be measured by the amount of capital it puts into the enterprise. But it has no rational application where there is no such relationship between investment and capacity to serve. There is no such relationship between investment and amount of gas produced. Let us assume that Doe and Roe each produces in West Virginia for delivery to Cleveland the same quantity of natural gas per day. Doe, however, through luck or foresight or whatever it takes, gets his gas from investing $50,000 in leases and drilling. Roe drilled poorer territory, got smaller wells, and has invested $250,000. Does anybody imagine that Roe can get or ought to get for his gas five times as much as Doe because he has spent five times as much? The service one renders to society in the gas business is measured by what he gets out of the ground, not by what he puts into it, and there is little more relation between the investment and the results than in a game of poker.

As the Commission pointed out (R. 257), a natural gas pipeline is assured a fair opportunity to earn a return. For until it has demonstrated with reasonable certainty that its project is financially feasible it will not be granted a certificate of public convenience and necessity authorizing it to construct its facilities. By contrast, an independent gas producer invests substantial sums without assurance that he will even have a product to sell, much less be able to sell it. Under the cost-of-service method of regulation, the producer who takes the initial risk in a previously unexplored area and proves it productive will often derive the least reward, for he will presumably pay less for his leasehold rights, and therefore have a lower rate base, than those less enterprising producers who follow in his footsteps. Moreover, inasmuch as natural gas royalties earned by the owners of land are usually proportionate to the unit price of the gas sold, the traditional rate-base method would invite royalty owners to lease their properties to the least efficient producers, whose high costs would entitle them to correspondingly high rates. See R. 261.

The regulation of producer rates on a cost basis entails a further anomaly. If the costs of the individual producer are the sole determinant of fair price, it is plain, the Commission observed (R. 261–262), that a rate which is reasonable for one owner of a well may be inadequate or excessive for a co-owner of the same well, so that gas from a single well might have widely varying price tags depending on who was selling it. This consequence is akin to the "delirious results" which Mr. Justice Jackson attributed to the

rate-base method when he remarked in *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 610:

> * * * These orders in some instances result in three different prices for gas from the same well. The regulated company is a part owner, an unregulated company is a part owner, and the land owner has a royalty share of the production from certain wells. The regulated company buys all of the gas for its interstate business. It is allowed to pay as operating expenses an unregulated contract price for its co-owner's share and a different unregulated contract price for the royalty owner's share, but for its own share it is allowed substantially less than either. Any method of rate-making by which an identical product from a single well, going to the same consumers, has three prices depending on who owns it does not make sense to me.[15]

Another major source of difficulty in attempting to regulate independent producers on a company-by-company cost basis is the fact that a producer can seldom foresee whether any given well will strike gas or oil (if it discovers any minerals at all) or, as is so often the case, both together. It becomes necessary, therefore, under the cost-of-service method, to allocate the producer's dry-hole expenses (*i.e.*, the expenses associated with drilling wells which turn out wholly unproductive) between the two commodities, and also to allocate the production costs of those wells which

[15] *Colorado Interstate* was, of course, decided before it was established by *Phillips* that the Commission has jurisdiction over independent producers.

produce oil and gas jointly. This cost allocation is a great deal more difficult and weighs much more heavily in the ultimate rate determination than the allocations required to be made in the regulation of traditional public utility rates. The Commission found (R. 259) that a great many formulas had been proposed in this proceeding for the cost allocation between oil and gas, and that the difficult choice between one or another method may, in the case of any given producer, mean the difference between bankruptcy and large profits.

Not least of all, there is the intolerable administrative burden of holding repeated rate cases for each of the thousands of independent producers subject to Commission jurisdiction. The Commission's opinion spells out in detail the magnitude of this task (R. 263). As of September 1960, 3,372 independent producers had 11,091 rate schedules and 33,231 separate rates on file with the Commission. The experience of the first six years of producer regulation led the Commission, at that point, to estimate that nearly 13 years would be required in order for its existing staff to dispose of the cases then pending, and that, even if that staff were immediately tripled, the Commission would not reach a current status with respect to its independent producer rate work until 2043 A.D.[16]

[16] The Commission also cited (R. 260) two additional difficulties incident to the use of the individual company, cost-of-service method: (a) The cost of gas per unit depends in part on estimates of reserves. These estimates are subject to wide variance, can never be precise, and often proved highly inaccurate, with qualified experts differing as much as 100% over reserves in the same formation. See *e.g.*, *El Paso Natural Gas*

In light of these considerations, there can be little doubt that the Commission's decision to abandon the individual company method of regulation had a reasoned basis.

C. IN THE CIRCUMSTANCES, THERE WAS NO ABUSE OF DISCRETION IN TERMINATING THE SECTION 5(a) PROCEEDING

As we have indicated, none of the petitioners, with the exception of California, challenges the power of the Commission, in the long run, to abandon the individual company cost-of-service method of determining producer rates and to adopt in its place a new method whereby natural gas is priced as a commodity on an area-wide basis. Petitioners insist, however, that until the area rate proceedings have come to fruition the Commission is obliged to continue regulating producer rates on the basis of the repudiated cost-of-service method, at least where such proceedings have already been initiated and hearings have been completed. Specifically, petitioners contend that the Commission abused its discretion in terminating the Section 5(a) proceeding in this case, after the examiner's decision had already been rendered, without undertaking to fix Phillips' rates for the future.

1. *The record was inadequate for purposes of prescribing future rates on a meaningful basis*

Section 5(a) does not require, or even permit, the Commission to determine just and reasonable rates

Co., Docket No. G-12580, 22 F.P.C. 900, 904, 918, *et seq.* And (b) the federal income tax laws relating to intangible drilling expenses and percentage depletion, as applied to individual producers, present complex and unresolved problems which may bear heavily upon costs.

unless it finds existing rates unjust, unreasonable, unduly discriminatory or preferential.[17] In *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353, this Court, construing identical language of the Federal Power Act, described the statutory finding as a condition precedent to the exercise of the Commission's power to determine rates. Here, the Commission doubted that it could make a finding that the rates were unjust and unreasonable because the basic assumption upon which the record had been made, *i.e.*, that the company's costs as revealed in the record should be the sole determinant of price, was not, in its view, a workable premise. See *supra*, pp. 7–8, 25–29.

The Commission had a second and independent reason for its decision to terminate the Section 5(a) proceeding. Assuming that the cost-of-service technique, though unsuitable as a permanent regulatory tool, might have been made to do service on an interim basis, there was the obstacle that the record had become seriously outdated. The cost data were for the test year 1954, and the Commission knew from its familiarity with the industry that costs and other conditions had changed with unprecedented speed between that year and 1960. Accordingly, it saw no escape from the conclusion that to require Phillips to file rates for 1960 and subsequent years based upon its revenue requirements of 1954 would be "without reason or justice" (R.

[17] "Whenever the Commission * * * shall find that any rate * * * is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate * * * to be thereafter observed and in force, and shall fix the same by order."

325). Petitioners Wisconsin and New York do not insist that the Commission was compelled to decide the case on the basis of the existing record. They contend, rather (No. 72, Pet. 24), that "a supplemental hearing, to compare Phillips' present revenues with its present costs, should be held." The Eastern Seaboard companies appear to agree that the record should be "augmented if necessary" (No. 74, Pet. 4). Nor would the dissent in the court below require the fixing of rates on the record as it stands. Judge Fahy speaks (R. 429–430) of "decisions on the present record, supplemented as may be found to be reasonably necessary." It is only California which would require that rates for the future be fixed on the basis of a test year which is now eight years old.

The question therefore comes down to this: Was the Commission obliged to devote its energies and those of its limited staff to constructing a new record in order that a determination might be made on the basis of a rate-making technique found to be basically unsuited to this purpose, or was it free to concentrate its efforts upon the development of a new technique deemed appropriate to the task?

2. *The Commission is pursuing a vigorous and effective program of interim rate regulation and has succeeded in arresting the upward trend in natural gas prices*

Petitioners' contention that the Commission abused its discretion in declining to reopen these proceedings and develop a new record based upon an up-to-date test year rests on mistaken assumptions: that the only alternative was a hiatus in regulation; that the Com-

mission has abdicated its function for an indefinite period; and that the consumer, as a consequence, faces the prospect of a continuing increase in the price he pays for natural gas. The facts are, however, that the Commission is following a vigorous and effective program of regulation during this interim period; that its decision in this case is not preventing effective disposition of other cases; that the rising trend in the price of natural gas has been arrested; and that to follow the course petitioners demand (*i.e.*, to reopen the proceedings) would tend to interrupt and delay the program now being pursued.

(*a*) *The Commission has arrested the upward trend in producer prices.*—In their brief in the court of appeals, the Eastern Seaboard Companies presented a graph showing the upward trend of natural gas prices from 1953 through 1960 and projecting the past increase through 1969.[15] The prognosis was that by 1969 the price of natural gas at the wellhead might be expected to approximate 30¢ per Mcf, or about double the 1960 figure.

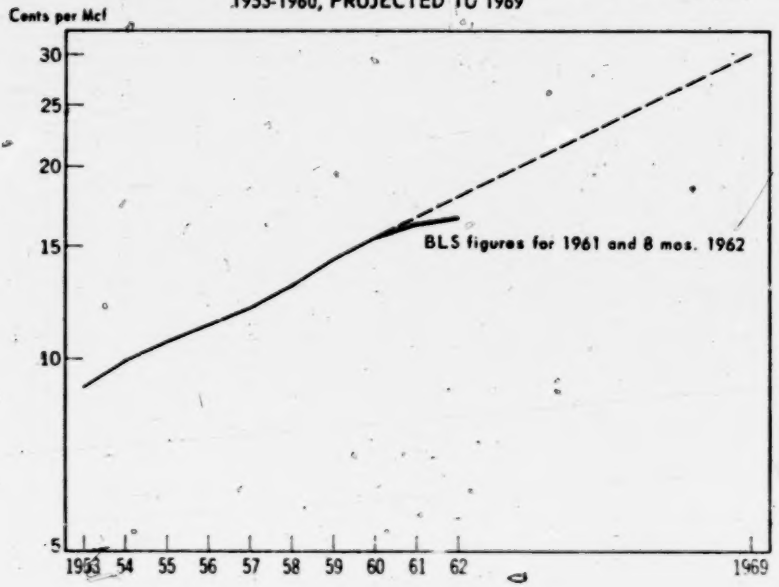
The fact is that since the Commission's decision in this case the rate of increase in natural gas prices has fallen off sharply. Indeed, the average price per Mcf for natural gas as of August 31, 1962 (16.36¢) was actually lower than it had been a year earlier (16.46¢), although the average for the entire twelve-month period ending August 31, 1962, was still slightly above

[15] The figures underlying the chart are those published by the Federal Power Commission for the earlier years and by the Bureau of Labor Statistics in the later years covered.

the average for the preceding twelve-month period (16.52¢ against 16.12¢).[19]

We reproduce the Eastern Seaboard Companies' chart here, with additions showing the Bureau of Labor Statistics figures for 1961 and the first eight months of 1962.

AVERAGE PRICE OF NATURAL GAS PAID BY INTERSTATE PIPELINE COMPANIES, 1953-1960, PROJECTED TO 1969

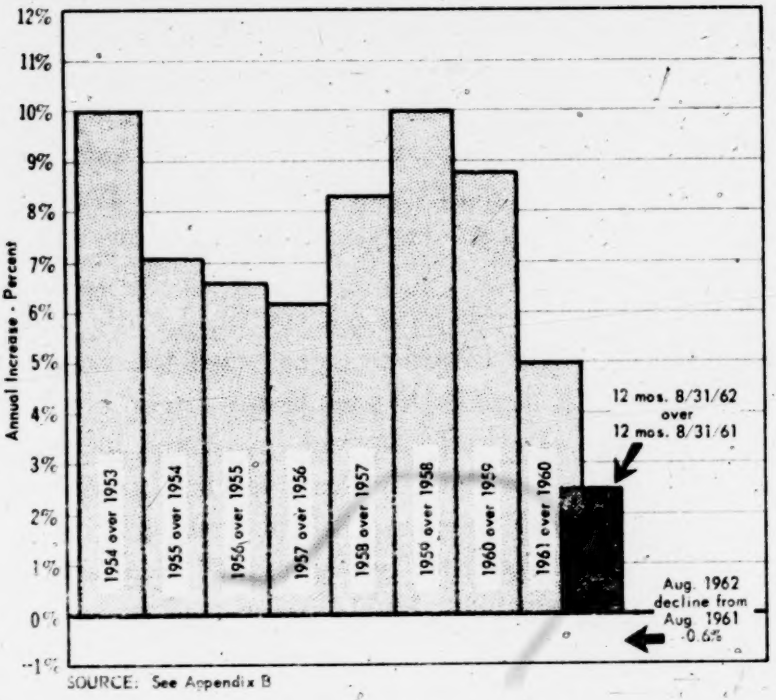


It is apparent that the trend is contrary to petitioners' predictions. Their chart showed an average increase of over 8% per annum up to and including 1960. The 1959 price level was 10% above the previous year and the rate of increase declined only slightly in 1960. The 1961 price, however, rose only 5% and the average price for the twelve months

[19] The sources for these figures, and for the figures on which the charts on pp. 34 and 35 are based, are shown in Appendix B, *infra*.

ended August 31, 1962, was but 2.5% above that for the preceding twelve-month period. And, as we have noted, the price in August 1962 was lower than that in August 1961.[19a] These figures are shown in the following chart:

PERCENTAGE INCREASES IN PRICE OF NATURAL GAS



SOURCE: See Appendix B

(b) *Changes in "policy statement" prices reflect an active regulatory program.*—The Commission has employed several means to achieve greater stability in

[19a] Since receiving the page proof of this brief, we have learned that the September 1962 figure is 16.72¢, and are informally advised that preliminary indications are that October will show a decline. The average for the 12 months ended September 30, 1962, was 16.54¢ compared with 16.16¢ in the previous 12 months, a rise of 2.4%.

wellhead prices. In the first place, simultaneously with its decision in the case at bar, it issued Statement of General Policy No. 61–1. That statement promulgated two ceiling prices for all the major producing areas of the country. The first ceiling (sometimes called the "new gas" ceiling) was designed to be used, and is being used, as a limitation on the prices at which the Commission grants certificates for new sales of gas (or for construction of pipeline facilities contemplating such "initial" sales) in the respective areas. The second ceiling price (sometimes called the "old gas" ceiling) marks the point at which the Commission will suspend proposed rate increases under existing contracts.

These ceiling levels have not remained static. New developments and information have led the Commission to modify them from time to time in an effort to achieve more reasonable current prices and increased assurance of price stability in the future. In the important South Louisiana area, the ceiling price for new gas was reduced last year, from 21.5¢ *plus* State taxes of 2.3¢ per Mcf to 21.25¢ *inclusive* of State taxes for gas subject to State taxes, and to 19.5¢ for gas taken from the off-shore federal domain.[20] Thus, the reduction for State-taxed gas was 2.55¢ per Mcf and for other gas 2¢ per Mcf, or a decrease in the range of 10%.

[20] Fourth Amendment to Statement of General Policy No. 61–1, issued October 31, 1961. The differential of 1.75¢ between the price of gas subject and not subject to State tax was fixed at less than the amount of the tax in order to encourage exploration for gas in the off-shore areas outside the State's jurisdiction.

In seven Texas districts, the ceilings for increased rates (*i.e.*, the "old gas" ceilings) were raised slightly (0.5¢ to 1¢).[21] As to three of these, the Commission corrected its earlier failure to include in the price an allowance for State taxes (all area ceilings are inclusive of such taxes), while in the other four the increased ceilings applied only where the producer, in proposing a price increase, agreed at the same time to eliminate from his contract certain provisions for price increases in the future.

By its most recent amendment to the Policy Statement,[22] the Commission reduced the price ceiling for initial sales from 18¢ to 16¢ in Texas District No. 4. This action was the result of reexamination of the facts in the light of present conditions, as revealed in a certificate case, *Skelly Oil Co., infra,* p. 39, nofe 26.

(*c*) *Stable prices at lower levels have been achieved in numerous important cases.*—The Commission has achieved lower current prices and greater assurance of price stability by its disposition of individual certificate cases (under Section 7) and rate proceedings (under Section 4 and Section 5). The Commission's files show that from September 30, 1960 to June 30, 1962, the Commission issued 2,880 temporary authorizations under Section 7. Of these, 684 were issued with price conditions, most of which brought the pro-

[21] Second and Third Amendments to Statement of General Policy 61-1, dated December 20, 1960 and March 29, 1961, respectively.

[22] Fifth Amendment to Statement of General Policy 61-1, dated August 30, 1962.

posed initial price down to the area ceiling.[23] In the other 2,196 cases, the proposed initial price was at or below the ceiling. In 31 cases, the temporary authorizations were superseded by permanent certificates under which the producer applicant reduced the proposed initial price to the ceiling price.

Numerous permanent certificate cases show substantial price reductions imposed by the present Commission, some of them in accordance with earlier court remands. For example, the *Catco* case[24] was remanded to the Commission on the ground that the proposed initial price of 21.4¢ per Mcf was not shown to be required by the public convenience and necessity. Upon reconsideration in the light of this Court's opinion, the Commission fixed a price of 18.5¢. *Continental Oil Co.*, 27 F.P.C. —, Opinion No. 351, Docket Nos. 11024, *et al.*, January 22, 1962, rehearing denied March 22, 1962, 27 F.P.C. —.

Similarly, on July 30 and August 24, 1962, the Commission approved settlements of 53 certificate applications in South Louisiana.[25] The prices were reduced from the 21¢–24¢ range to 19¢ for gas produced from the off-shore federal domain and 20.625¢

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[23] In a small number of cases the proposed initial price was permitted to be collected subject to refund—a practice which has been discontinued—and in another small group of cases the producers were permitted to collect a price which exceeded the area ceiling by an amount which reflected the above-normal heating value of the gas (the "B.t.u. adjustment"), subject to refund of the excess if subsequent proceedings justify a refund.

[24] *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378.

[25] F.P.C. Release No. 12140, *Texaco Inc., et al.*, Docket Nos. G–13169, *et al.*, and F.P.C. Release No. 12183, *Socony-Mobil Oil Company Inc. et al.*, Docket Nos. G–13746, *et al.*

for on-shore gas subject to State taxes. Refunds of over $5,800,000 were provided, and the annual reduction in cost of gas to the three pipeline purchasers was over $3,000,000. In addition, provision was made for moratoriums on future price increases.

In *Skelly Oil Company*, Docket No. G–18638,[26] the Commission reduced to 15¢ the price for 31 sales of gas in Texas District No. 4, where the producers had asked for prices ranging up to 18¢. This proceeding resulted in the reduction in the Policy Statement price, as noted *supra*, p. 37.

In rate cases, too, the Commission has been active in reducing prices and assuring future price stability, as the recent Shell, Ohio Oil and Tidewater settlements[27] demonstrate. The first of these covers virtually all of Shell's rate schedules other than those under review in the current Permian Basin area rate hearings and those involved in pending show-cause or certificate proceedings. The approved price levels are all at or below the Policy Statement levels except for two schedules where special factual circumstances obtain. Refunds amount to $8.7 million and rates are reduced by $7.2 million annually. Among the most important provisions of the settlement is the company's agreement not to file rate increases until 1965 and, with respect to 12 rate schedules, until 1972.

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[26] Commission Opinion 362, August 30, 1962, rehearing granted, October 26, 1962 (mimeo.).

[27] *Shell Oil Co.*, Docket No. G–9446, order, August 1, 1962; *The Ohio Oil Co.*, Docket No. RI60–92, order, June 28, 1962; *Tidewater Oil Co.*, Docket No. G–13310, orders, June 15 and July 11, 1962. These orders have not yet been reported but are available in mimeographed form.

For certain schedules, rate increases are limited to 1¢ per Mcf every five years.

New York and the Eastern Seaboard Companies, which intervened, made no objection to the Shell settlement. California, which objected only on the ground that the Commission should have fixed just and reasonable rates for the few schedules eliminated from the settlement, did not seek rehearing and thus abandoned even that objection. Nonetheless, New York, which made no objection at the appropriate time, bitterly criticizes the similar Tidewater settlement in its brief (No. 72, Br., p. 35), claiming that it concurred only "to end the matter and attain some stability in gas costs (and relief from high Section 4(e) rates)." We submit that settlements which successfully accomplish these results can scarcely be cited as evidence of regulatory hiatus.

All of the foregoing settlements leave open the question of further adjustment of rates on the basis of the pending area rate hearings; that is, nothing in the settlement precludes any action which may be taken in the area proceedings.

Moreover, the Commission has ordered prompt hearings in Section 4(e) proceedings involving increased rates which exceed the Policy Statement levels and which, if not acted on prior to the end of the suspension period, would trigger similar filings by other producers (by operation of favored-nation or price redetermination clauses in their contracts). Thus, the Commission, in June 1962, suspended and set for expedited hearing increased rate filings (in the 25¢ per Mcf range) for sales in South Louisiana in order that

decision in the proceedings could be made prior to expiration of the suspension period.[28] In two other instances, the Commission has similarly adopted the expedient of an accelerated hearing. In each instance, the increased rate filings were either withdrawn[29] or were disallowed.[30]

Even more recently in *Hunt Oil Company*, Opinion No. 365, issued October 17, 1962, the Commission remanded Section 4(e) proceedings for the taking of additional evidence on the reasonableness of that producer's rate increases. The case is one in which a relatively minor supplementation of the record is required. In taking this action the Commission explained (slip. op., p. 5):

> * * * Cost-of-service was the method which was used in this proceeding and others pending before the Commission prior to the commencement of the area rate proceedings and, as we have previously indicated, we intend to continue to process and decide such proceedings as promptly as the record in each case permits. * * *

At the same time, the Commission, consistently with its approach in the instant case, refrained from pursuing the Section 5(a) proceeding against the company. In this connection, it stated (*id.*, p. 6):

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[28] *H. L. Hunt, et al.*, Docket Nos. RI62-467, et al., order issued June 29, 1962 (unreported).

[29] *Humble Oil & Refining Company, et al.*, Docket Nos. RI61-132, et al., order issued February 14, 1961 (unreported). Phillips was one of the companies filing an increased rate and withdrawing the same.

[30] *Union Producing Company*, 24 F.P.C. 841, Docket No. RI60-435.

> The Section 5(a) aspect of the proceedings is in a different posture. There are currently pending area rate proceedings in the Permian Basin and Southern Louisiana in which a large percentage of Hunt's jurisdictional sales are the subject of investigations pursuant to Section 5(a). It is our hope that area proceedings will result in a timely determination of Hunt's rates for the future. * * *

Significantly, most of the cases discussed above (*supra*, pp. 38–40) involve rates in South Louisiana where petitioners have charged that the Commission has allowed prices to run wild. The Eastern Seaboard Companies (No. 74, Br. p. 23), refer to South Louisiana as "the most important example" of an area where the Commission has exercised little or no effective price regulation, and state (*id.*, App. D–2) that 13 major producers sold 436 million Mcf subject to Commission jurisdiction at prices above the 21.25¢ initial price ceiling in that area in 1960, and that 134 million Mcf of that volume was not subject to refund. These figures are both erroneous and out of date.

As explained in Appendix C, *infra*, pp. 69–70, the 13 producers actually had 399 million Mcf of jurisdictional sales in 1960 at prices higher than the 21.25¢ ceiling, and only 44 million of that total was not subject to refund. For Phillips alone, the amount of such sales not subject to refund was 4,723,411 Mcf (less than 1% of its sales), instead of the 23,950,166 claimed by petitioner. Since then, the settlements described above have reduced to a figure at or below the ceiling prices for 155 million Mcf of the above-ceiling jurisdictional sales by these 13 producers.

This leaves 244 million of 1960 jurisdictional sales at prices above 21.25¢, and of those only 30 million Mcf are not subject to refund (*i.e.*, 12% of the total, instead of 31% of a total almost twice as large, claimed by petitioners).

The Eastern Seaboard Companies acknowledge (Br., p. 24, fn. 9) that their figures "may overstate" the amount of jurisdictional revenues not subject to refund, but it seems clear that their Appendix D-2 is valueless even as an approximation. Their Appendix D-1 is also subject to grave infirmities, the magnitude of which we cannot estimate. It includes large volumes of non-jurisdictional purchases. Its caption refers to "Prices Paid for Natural Gas by Interstate pipelines," but the fact that those pipelines make many non-jurisdictional purchases does not appear. Indeed, the annual reports of the pipeline companies to the Commission (FPC "Form 2" reports), on which the table is based, show this to be the fact. Thus, insofar as the claim of the Commission's failure to regulate gas prices rests on Appendix D-1, it is based in substantial part on transactions over which the Commission has no control.

In sum, not only has the rising trend of prices of natural gas at the wellhead been largely leveled off during the two years since the Commission decision here under review, but resolution of the important cases discussed above indicate that in the last few months the trend of prices in South Louisiana, about which petitioners express so much concern, has been downward instead of upward. Furthermore, the moratoriums in the settlement agreements, which

could not have been imposed by Commission order, provide effective limitations on price increases in the future.

3. The remand sought by petitioners would cause, rather than cure, delay in the regulatory program

As we have seen, all of the petitioners (except California, which insists that the rates should have been prescribed on the basis of the 1954 test year) argue that the Commission was obliged to reopen the record in order to obtain an up-to-date cost showing. In addition, the Eastern Seaboard Companies urge that the Commission should similarly bring to a conclusion several other Section 5(a) proceedings which were instituted prior to its decision here and in which hearings have been completed (No. 74, Br. 26–27, and Appendix A at p. 33). However, if the Commission, in 1960, had assigned its limited staff the task of compiling a new record in the *Phillips* case, and also completing (and in some instances updating the record in) the twenty or more other Section 5(a) proceedings then pending,[31] it certainly could not have proceeded vigorously with its new regulatory program and doubtless would have been obliged to postpone the launching of the area rate proceedings now under way—proceedings which, in its view, offer the only real promise of effective and comprehensive regulation.

The Commission must necessarily have broad discretion in determining priorities among competing regulatory activities. *Federal Communications Com-*

[31] See brief of Eastern Seaboard Companies in No. 74, Appendix A, p. 33.

mission v. *WJR, The Goodwill Station*, 337 U.S. 265. That discretion was properly exercised here when, expressly rejecting the contention that the record should be brought up to date, the Commission stated (R. 397):

> * * * For the future it is our judgment that the interest of consumers and the exigencies of regulation will be better served in rate proceedings brought on an area basis rather than on an individual company basis. Therefore, we do not think it in the public interest to reopen these proceedings, to determine a cost of service on the basis of completely new evidence and to attempt to determine rates on the basis of Phillips' individual cost of service.

It is clear, moreover, that a decision by this Court, the effect of which is to require the Commission to reopen the records in this and all other unsettled Section 5(a) cases in which hearings have been completed, would necessarily tend to delay area rate proceedings. At present, as is shown by Appendix A of the brief of the Eastern Seaboard Companies, there are eleven outstanding Section 5(a) proceedings (including this case) in which hearings have been completed and four in which the examiner's decision has been rendered. In virtually all of these cases, the record was based on a test year now four to seven years old. If the *Phillips* case alone were to be remanded to the examiner with directions to obtain a new record based upon an up-to-date test year, the ultimate Commission decision would probably be a year away. To be sure, some of the major principles which would be applied

to the new cost data submitted by the parties have already been decided by the Commission's decision here under review. But new issues might be expected to arise in relation to the special circumstances of the new test year, and, in any event, the preparation of cost-of-service exhibits by Phillips, and of responsive exhibits by the other parties, would in itself consume many months. Thus, assuming this Court's decision—by hypothesis, adverse to the Commission—were handed down in the first quarter of 1963, the final rate determination could not be anticipated much earlier than the first quarter of 1964. And to require the assignment of that portion of the Commission's staff which is available for producer rate cases to determining rates by the old method in this and other Section 5(a) proceedings, would seriously impede the area rate program.

Petitioners suggest that area proceedings in all of the producing areas may not be completed for a great many years, with estimates ranging up to fourteen years (No. 74, Br., p. 15). We do not underestimate the magnitude of the task which confronts the Commission, particularly while the new approach is still in its formulative stage, but believe that these extreme estimates are highly unrealistic. The Eastern Seaboard Companies refer to testimony of Joseph C. Swidler, Chairman of the Federal Power Commission, before a subcommittee of the House Appropriations Committee on February 26, 1962 (No. 74, Br., pp. 13–14), in which Chairman Swidler declared, among other things, that it "will take a year or two probably

before we could hope to come out with the answer in the *Permian Basin* case." Even if one accepts the more cautious two-year estimate, this pioneering case would be concluded by the early part of 1964, no later than the anticipated decision-date in the instant case if it were remanded by this Court (see *supra*, p. 45). Moreover, after the basic regulatory patterns have been established in the pilot area-rate cases (*Permian Basin* and *South Louisiana*), the Commission should be able to conduct and conclude other area proceedings with greater speed.

We also point out that approximately 35% of the gas sold by Phillips under its jurisdictional rate schedules is produced in the Permian Basin, and another 7% in South Louisiana,[32] the two areas in which area-rate proceedings are already in progress. It would appear, therefore, that area-rate determinations governing a substantial portion of Phillips' sales *and sales of many other major producers as well* may be available within roughly the same period that it would take to complete a Section 5(a) proceeding covering Phillips alone.

Certainly, it is clear that the Commission cannot effectively pursue both objectives at the same time. It cannot make optimum progress in establishing area rates if simultaneously it must also establish individual company rates according to the rate-base technique it found wanting. It cannot fix rates for the industry as a whole if it must continue, company-by-company, to undertake the kind of proceeding to

[32] Calculated from Phillips' Annual Report to the Federal Power Commission (FPC Form 301) for 1960.

which the Court referred when it noted that "* * * the delay incident to determination in § 5 proceedings * * * appears nigh interminable." *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, 389. Granting that there are problems of transition, it should not be compelled to expend its necessarily limited capacities in travelling two divergent roads leading to inconsistent ends. As the Court of Appeals for the District of Columbia Circuit observed in *United Air Lines* v. *Civil Aeronautics Board*, 228 F. 2d 13, 16:

> * * * the problem of administration of its own business is singularly within the Board's prerogative. As an informed body it must have wide scope in its administration of the business committed to its charge. * * *

II. TERMINATION OF THE SECTION 4(e) PROCEEDINGS WAS APPROPRIATE IN THE CIRCUMSTANCES OF THIS CASE

With one minor exception,[33] all of the rates involved in the Section 4(e) dockets have been superseded by subsequent increases which the Commission has suspended in other proceedings. These rates, therefore, have no current or future significance. The only issue is whether refunds should have been ordered for the periods during which they were in effect.[34]

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[33] Docket No. G-8623, involving an increase of $21,324 annually.

[34] The positions of petitioners with respect to the Section 4(e) proceedings have varied considerably. Neither New York nor California complained of the terminations in the court below. The Eastern Seaboard Companies objected to the Commission's failure to make findings of justness and reason-

As noted *supra*, p. 8, Phillips' indicated total revenue requirement for 1954 was $59,725,315, or 12.16¢ per Mcf (after adjustments). Its test year jurisdictional revenues were $45,568,291. The rate increases involved in these Section 4(e) filings amount to $5¼ million (R. 75), or only about 37% of the deficiency. It was on this basis, *i.e.*, that the rates in question fell far short of the cost of service, that the Section 4(e) proceedings were terminated and Phillips' refund obligation discharged.

Petitioners accept the Commission's findings,[35] but argue (No. 72, Br. p. 45) that the termination of the Section 4(e) proceedings was erroneous because:

> * * * it permits Phillips to retain the $5.3 million increase for each year during the period 1955–1959. If we could assume that Phillips' revenues remained constant during the 1954–1959 period, then the Commission's treatment insofar as it related to level of revenue would be eminently correct. But in point of fact, Phillips' revenues did not remain constant; as the result of additional sales volumes, increased rates for old sales, and new sales at higher prices, revenues virtually doubled.

This is essentially an argument that the record was stale and should have been reopened to allow petitioners to show that at a later stage revenues exceeded costs. But neither before the Commission nor in the

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ableness, while Wisconsin, which was the only party to challenge the Commission's cost-of-service figures in the court below, has abandoned that challenge here.

[35] See note 34, *supra*.

courts have petitioners shown that the Commission abused its discretion in failing to follow this course. See *Interstate Commerce Commission* v. *Jersey City*, 322 U.S. 503, 514–517, and cases there cited.

Specifically there is no showing here that the 1954 record was not reasonably applicable to the 1955–59 period (during which the vast majority of the increased rates were in effect) for purposes of determining whether refunds were due. The fact that Phillips' revenues "virtually doubled" during that period proves nothing in itself—its volumes had increased. The same table of figures on which Wisconsin and New York rely (Br., p. 24), to show the revenue increase shows also—and no less importantly—the average revenue per Mcf in each year. Those averages are as follows:

1955	1956	1957	1958	1959
8.9¢	9.4¢	9.9¢	11.1¢	12.3¢

When it is recalled that Phillips' test year revenue requirements were 12.16¢ per Mcf, the claimed increase in revenues falls into proper perspective. Even if we assume that Phillips' unit costs did not increase during that period of generally rising wages, deeper drilling, higher purchased gas costs, etc., there is still no showing that 1954 was not an appropriate basis for deciding the question of refunds for the 1955–1959 period. It was only for purposes of future rate-making under Section 5(a), i.e., for years subsequent to 1960, that the 1954 figures were obsolete.

It was only in those years that the company's average rate went beyond the 12¢ range.

Petitioners make two further arguments. The first is that the Commission, though deciding that no refunds were necessary, failed to make the finding that the rates involved in the Section 4(e) proceedings were just and reasonable. This claim is pointedly answered by the opinion of the court below (R. 420):

> * * * The contention is that the Commission made no decision. We think the point is not well taken. The Commission did make a clear decision, after elaborate findings, upon the one substantive issue before it. It did say it "terminated" the proceedings, but it terminated them after deciding the basic and dispositive issue, and it entered an order on that decision. Its "termination" was much like that of a judge after he has rendered findings, conclusion and judgment.
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> Whether the Commission should have preceded its ultimate conclusion of no-refund with an intermediate conclusion of justness and reasonableness in the rates at issue, and whether it properly added the termination order to its decisive finding, seem to us to be immaterial queries. The important feature is that the Commission reached and decided the critical substantial issue, rationally and upon detailed findings of basic facts upon an ample record.

The Commission's finding on that dispositive issue—based upon a subsidiary finding, undisputed here, as to Phillips' cost of service for the test year 1954 [36]—

[36] A 1956 study submitted by Phillips indicated, moreover, that "cost of service for that year was not very different from 1954" (R. 272).

was that "* * * these rates have produced revenues less than Phillips' cost of service during the periods that they were in effect" (R. 325–326). By this finding, the Commission laid to rest the only question presented in these Section 4(e) dockets.

The sole remaining argument is that there were differences in the rates involved in the various Section 4(e) proceedings, with some of them above and some below the average cost of service. New York (which has not previously attacked the Section 4(e) terminations) and Wisconsin (which has not previously claimed that Phillips' rates are discriminatory) now claim (No. 72, Br. pp. 45–46) that since seven of the twelve rates in question exceeded the average cost of service, the Commission should have found that "this pattern of rate differentials constituted undue discrimination or preference."

This point, to begin with, is not properly here, not having been raised below or presented to the Commission. Although Wisconsin argued in its application for rehearing that some of the rates were improper because they exceeded the cost of service (R. 360), none of the petitioners urged that the rates were discriminatory. It is well settled that parties are precluded by Section 19(b) of the Act from raising before the courts a point which they failed to raise before the Commission itself. *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 324 U.S. 635, 647, 650–651; *Federal Power Commission* v. *Colorado Interstate Gas Co.*, 348 U.S. 492; *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 364 U.S. 137, 157.

In any event, the charge of discrimination is not supported. Sections 4(b) and 5(a) of the Act forbid rates which are unduly discriminatory or preferential, but mere differences in rates are not *per se* illegal; it must appear that they are not justified by the costs of the respective services, by their values, or by other conditions. *United States* v. *Illinois Central R.R. Co.*, 263 U.S. 515, 524. The mere fact that some rates exceed the average cost-of-service, or may be higher than the rates for other gas produced and sold by the same company in different areas and under different circumstances, does not render them unduly discriminatory or preferential, and the Commission found (R. 325) that nothing in the record showed these rates to be so. No party is contending, or reasonably could contend, that there is any evidence in the record which would enable the Commission to allocate cost of service rate by rate, or otherwise make a finding of discrimination.[37] Absent a showing that the gas sold under the various rate schedules is produced under similar conditions, is of similar quality, and is sold in similar markets in similar quantities under contracts negotiated at roughly the same time, a claim of discrimination based solely on price differences is wholly insubstantial.

[37] Unlike the *Hunt* case, *supra*, p. 41, where the Commission directed the examiner to take evidence on discrimination between rates, the Section 4(e) rates in the case at bar have no current or future applicability and are uniformly below the "new gas" ceilings in the respective areas. Consequently the Section 4(e) rates here can have no impact on the level of prices.

III. CALIFORNIA'S ARGUMENTS ON SPIRAL ESCALATION CLAUSES ARE NOT PROPERLY RAISED AND IN ANY EVENT LACK MERIT

California contends that the Commission erred in refusing to reject the proposed rate increases based upon "spiral escalation clauses" in three of Phillips' contracts (No. 73, Br. pp. 56–61).[38]

This argument relates to three of the twelve Section 4(e) dockets Nos. G–11217, G–10883 and G–10793. As to the first two dockets, it is premature. As to the third, California lacks standing to complain. And, as to all three, the contention is without merit. We first discuss the question of prematurity.

1. The spiral escalation clauses, as explained *supra*, p. 9, fn. 9, provide that whenever a specified commodity price increase (*e.g.*, the Bureau of Labor Statistics wholesale price index) shall have risen by a prescribed number of points and a general increase in the pipeline customer's rates shall have been instituted, the Phillips' rates to the customer shall be increased proportionately. Rate increases based upon such clauses, like any other increases filed with the Commission, may be suspended under Section 4(e) and made subject to refund.

Two of the three Section 4(e) dockets in which the contracts contained such clauses—Nos. G–11217 and G–10883—were not terminated by the Commission. See ordering paragraphs (B) and (C) of the Commission's order, R. 332. As to these, no final order

[38] Wisconsin has apparently abandoned in this Court the attack which it made below with respect to spiral escalation clauses.

has been issued and the review here sought is premature. The reason no final order was made is that El Paso and Panhandle Eastern, the pipeline purchasers of the gas sold under the schedules involved in those dockets, argued that the increases were dependent on the operation of spiral escalation clauses in their own resale contracts, which were then under consideration in other dockets (G–4769 and G–2506). Since the amount of permissible increases in the latter dockets, which related to the rates charged by the pipelines, had not been decided, the effect of these increases on Phillips' rates by virtue of the spiral escalation clauses in its contracts could not yet be determined in the Phillips hearings.

Section 19(b) of the Natural Gas Act limits the right of review to parties who are "aggrieved" by an "order" of the Commission. The order here under review does not determine the amount of the rate increase, if any, that will be allowed in either of these two dockets. It leaves them open for further administrative action. Plainly, if the final order results in disallowance of the proposed increases, neither California nor anyone else (except, perhaps, Phillips) will be aggrieved. For that reason, California's attack is premature, and the Commission's action with respect to these two dockets is not properly before the courts. *Northwestern Electric Co. v. Federal Power Commission*, 125 F. 2d 882, 887 (C.A. 9), citing *Federal Power Commission v. Metropolitan Edison Co.*, 304 U.S. 375, 383. See also *California Oregon Power Co. v. Federal Power Commission*, 239 F. 2d 426, 433 (C.A.D.C.).

2. In Docket No. G–10793 there was no contention that the escalation clause had not become effective according to its terms. Since the decision in that docket did not depend on the decision in any pipeline rate docket, G–10793 was among those in which proceedings were terminated. However, the only party affected by that termination is Wisconsin, which no longer attacks it.

California's asserted interest in the operation of spiral escalation clauses derives from the fact that "the price of natural gas to the California consumer is largely dependent upon the rates set by the [Federal Power] Commission for the sale of gas by [El Paso Natural Gas Company, a pipeline] for resale in California. These rates, in turn, are dependent to a great extent upon the cost to El Paso of natural gas purchased by it from Phillips" (No. 73, Br. p. 57). But Docket No. G–10793 does not involve a sale to El Paso or any other California supplier. Instead, it relates to a sale in Hansford County, Texas, by Phillips to Michigan-Wisconsin Pipe Line. Wisconsin, which is supplied by this customer of Phillips, has evidently not considered this sale, made in 1956 [39] at a price of 10.858¢ per Mcf and since superseded, to be sufficiently important to warrant raising this question here. California has not alleged and, we believe, could not show that it is in any way affected by Phillips' price for this sale. No claim of financial loss to any citizen of California is made. The only claim made is that spiral escalation clauses in general

[39] Filed June 25, 1956, as Supplement No. 19 to Phillips' F.P.C. Gas Rate Schedule No. 4.

are "derogatory of the public interest and void in this regulatory setting."[40]

We do not question the right of a State to attack a Commission order that affects its citizens adversely. But States are not the guardians of one another's citizens. To allow California to attack an order which has no impact on anyone California represents would require an unwarranted extension of the concept of aggrievement. The courts have consistently declined to go so far. See, *e.g.*, *United States Cane Sugar Refiners' Ass'n.* v. *McNutt*, 138 F. 2d 116 (C.A. 2). The plain language of section 19(b) of the Natural Gas Act requires aggrievement before suit can be brought, and aggrievement involves, at the very minimum, some adverse effect. California lacks standing to challenge the Commission's disposition of a docket involving no interest of California.

3. In any event, the Commission's conclusion that a spiral escalation clause provides adequate authority for the filing of an increased rate, which thereupon becomes subject to the provisions of Section 4 of the Act, is correct on the merits. Admittedly, as California points out, the Commission, in the period subsequent to its decision in this case, has promulgated a series of rule-making orders condemning spiral escalation clauses and other so-called "indefinite" price-changing provisions,[41] as against the public interest. By Orders Nos. 232 [25 FPC 379, 26 F.R. 1983 (1961)]

[40] No. 72, Br., p. 56.

[41] Certain designated types of price-changing provisions are permitted by the orders cited in the text, *e.g.*, provisions that change a price to a specific amount at a definite date.

and 232-A [25 FPC 609, 26 F.R. 2850 (1961)], it announced that such clauses, where contained in contracts executed on or after April 3, 1961, would thereafter be held to be without effect. By Order No. 242 [27 FPC —, 27 F.R. 1356 (1962)], it announced that contracts containing such clauses would be unacceptable for filing after April 2, 1962. Those orders, however, are exclusively prospective in their application, and they do not purport to govern contracts executed prior to April 3, 1961. In its 1960 decision here, the Commission noted that while "we do not approve of such clauses in principle, there is not sufficient basis on this record to hold them so derogatory of the public interest as to be void as a matter of law." (R. 327). The three contracts which contain the spiral escalation clauses involved here are dated 1943, 1945, and 1953 (No. 73, Br., App., pp. 14–17). All of them, therefore, were consummated not only before the Commission's recent orders outlawing spiral escalation clauses for the future, but even before the Commission began regulating independent natural gas producers under this Court's 1954 decision in the instant case (347 U.S. 672).

California insists, nonetheless, that if spiral escalation clauses have now been found by the Commission to be incompatible with the public interest, they should be struck down even when contained in contracts executed prior to April 3, 1961. The complaint here, it should be emphasized, is not that the Commission failed to render Phillips' spiral escalation clauses inoperative for the future. As to the prospective operation of such clauses, the Commission

concluded that (R. 327) "We need not require that they be eliminated, since Phillips has already agreed to do so." No party disputes this conclusion. Rather, the contention is that the Commission should have treated the spiral clauses as void *ab initio*. In that event, the clauses would not have constituted valid contractual consents by the buyers to the filing of Phillips' increased rates in these three dockets and, absent such consent, those filings would now have to be rejected retroactively as nullities, regardless of whether the rates collected under them were just and reasonable in relation to the company's cost of service. See *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332.

In effect, California is arguing that the Commission was not only free, in the exercise of its experienced judgment, to nullify spiral escalation clauses, but that it was legally compelled to do so, and, moreover, to do so on a retroactive basis even with respect to contracts executed long before the Commission's action. We submit that this extreme position is wholly unreasonable. California makes no showing that when these contracts were made (as far back as 1943) it was contrary to the public interest for producers, who were then selling gas at extremely low prices, to negotiate provisions calling for increases proportionate to those received by their customers. In any event, until the Commission adopted its prospective orders in 1961 and 1962, there was no statute, common-law rule or administrative regulation which compelled or even invited the conclusion that these spiral provisions were

void as a matter of law."[42] Courts of appeals, when called upon to review such provisions, never suggested that rate increases filed pursuant to them had to be rejected. *Phillips Petroleum Co.* v. *Federal Power Commission*, 227 F. 2d 470 (C.A. 10), certiorari denied *sub nom. Michigan Wisconsin Pipe Line Co.* v. *Phillips Petroleum Co.*, 350 U.S. 1005; *Kerr-McGee Oil Industries, Inc.* v. *Federal Power Commission*, 260 F. 2d 602 (C.A. 10). Indeed, this Court itself sustained the right of a seller to file an increase under a contract which authorized him, in effect, to file such increases *ad libitum*. *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division*, 358 U.S. 103. If a contract which places no limitation whatever on the seller's right to file is not invalid, absent a statute or regulation making it so, then neither, we submit, is one which is limited by the provisions of a spiral escalation clause.

If the Commission acted reasonably in 1960 when it refused to strike down the spiral clauses in Phillips' contracts, its action certainly did not become unreason-

[42] California places mistaken reliance on language in a 1954 Commission opinion, *Michigan-Wisconsin Pipe Line Co.*, 13 F.P.C. 326. The Commission there was considering the cost to the pipeline of gas purchased from Phillips. Those claimed costs included increases based on escalation clauses which had not yet become effective. The Commission there held, and properly so, that the mere existence of the spiral clauses could not be treated as triggering a rise in the pipeline's costs, because any rate increases Phillips might file pursuant to those clauses would be subject to Commission review under § 4(e) before becoming effective. In the meantime, the pipeline's costs were to be measured by Phillips' presently filed rates.

able merely because it later saw fit to issue orders banning such provisions for the future. To hold otherwise would be to say that the Commission had no choice but to make those orders retroactively applicable to contracts, and also to rate filings, prior to April 3, 1961. There is ample justification, however, for the Commission's decision to restrict its policy to future contracts. In the first place, if the Commission were to void all spiral escalation clauses, whenever executed (or if this Court, by its decision here, were to do so), it might well be inundated by rate filings of producers claiming, whether validly or otherwise, that the contracts were no longer in force and therefore no longer restrained them from filing for higher rates.

Moreover, by treating long-standing spiral escalation clauses as nullities, the Commission might be depriving Phillips and other producers of contract rights for which they bargained at a time when such clauses were not even remotely suspect on public policy grounds. Here, for example, the buyers' authorization for Phillips to file increases in accordance with the spiral clauses may have been consideration for Phillips' agreement to the original price. Had Phillips foreseen at the time it entered into these contracts that the spiral clauses might later be deemed void *ab initio*, it might have been able to insist upon a higher price for its gas or else to negotiate a type of price escalation clause which would not have fallen within the proscription of the Commission's subsequent or-

ders. Whether these considerations would bar the Commission from regulating spiral clauses on a retroactive basis is a question not presented here. It seems clear, however, that the Commission was not *obliged*, as a matter of law, to impose such harsh consequences upon Phillips. This Court refused to reach such a result in a similar situation involving a contract subject to regulation under the Interstate Commerce Act. *Southwestern Sugar & Molasses Co., Inc.* v. *River Terminals Corp.*, 360 U.S. 411. There the contract contained an inherently illegal condition, relieving respondent from liability for its own negligence, which was filed as part of a tariff with the Interstate Commerce Commission. A like clause in a contract not subject to I.C.C. control had previously been held void in *Bisso* v. *Inland Waterways Corp.*, 349 U.S. 85, on the ground that it was contrary to public policy. In the *Southwestern Sugar* case this Court said (360 U.S. at pp. 417–418):

> * * * For all we know, it may be that the rate specified in the relevant tariff is computed on the understanding that the exculpatory clause shall apply to relieve the towboat owner of the expense of insuring itself against liability for damage caused tows by the negligence of its servants, and is a reasonable rate so computed. If that were so, it might be hard to say that public policy demands that the two should at once have the benefit of a rate so computed and be able to repudiate the correlative obligation of procuring its own insurance with knowledge that the towboat may be required to respond in

damages for any injury caused by its negligence despite agreement to the contrary. For so long as the towboat's rates are at all times subject to regulatory control, prospectively and by way of reparation, the possibility of an overreaching whereby the towboat is at once able to exact high rates and deny the liabilities which transportation at such rates might be found fairly to impose upon it can be aborted by the action of the I.C.C. The rule of *Bisso*, however applicable where the towboat owner has "the power to drive hard bargains," may well call for modification when that power is effectively controlled by a pervasive regulatory scheme.

CONCLUSION

The basic question in this case concerns the permissible scope of the Commission's discretion when it is faced with a record which does not permit it to fix future rates. That question would not be worth the attention of this Court but for the extraordinary history of this case. We have shown that a termination of proceedings on this record was a reasonable exercise of discretion in the light of the regulatory program then set forth and now being implemented. A remand for the purpose of bringing the record up to date can only result in interference with that program and in the enforced use of a method which the Commission rejected for reasons which are legally sufficient, grounded in experience and plainly within the agency's special competence.

The judgment should be affirmed.
Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
RALPH S. SPRITZER,
FRANK GOODMAN,
Assistants to the Solicitor General.
RICHARD A. SOLOMON,
General Counsel,
HOWARD E. WAHRENBROCK,
Solicitor,
LEO E. FORQUER,
Assistant General Counsel,
ARTHUR H. FRIBOURG,
Attorney,
Federal Power Commission.
OCTOBER 1962.

APPENDIX A

The Natural Gas Act, Section 4(e), 15 U.S.C. 717c(e) and Section 5(a), 15 U.S.C. 717d(a), as amended, provides as follows:

SEC. 4. (e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company [1a] or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; [1a] and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any

[1a] Subsection 4(e) was amended May 21, 1962, by Public Law 87-454, 87th Cong., 2d Sess. [S. 1595], 76 Stat. 72.

amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 76 Stat. 72 (1962); 15 U.S.C. § 717c]

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company: but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

APPENDIX B

Sources for Charts on Pages 34, 35.

The chart shown by the Eastern Seaboard Companies in their brief below is based on the following data, in cents per Mcf, as stated in footnote 31 on page 26 of that brief:

	1953	1954	1955	1956	1957	1958	1959	1960
FPC	9.0	9.9	10.6	11.3	12.0	13.0	14.3	
BLS						12.9	14.3	15.5

The "FPC" data for 1953–59 are as reported by the Commission in "Direct Sales by Producers of Natural Gas to Reporting Interstate Pipeline Companies." The "BLS" data for 1958–60 are as reported by the Bureau of Labor Statistics in its "Wholesale Prices and Price Indexes."

The following monthly figures showing the price paid by pipelines for natural gas for the period since the beginning of 1960 are also taken from the Bureau of Labor Statistics' "Wholesale Prices and Price Indexes." The prices for each month from January 1960 through August, 1962 are found as Series 05–31–01 in the monthly issues of that publication for February, 1960 through September, 1962, respectively. The BLS figures, which are reported in dollars per million cubic feet, have been converted to cents per thousand cubic feet for purposes of consistency with the remainder of this brief, and consequent greater clarity.

[Cents per Mcf]

	1960	1961	1962
January	14.98	16.01	16.40
February	14.98	16.20	16.72
March	15.16	16.12	16.60
April	15.15	16.15	16.55
May	15.18	16.21	16.74
June	15.29	16.28	16.61
July	15.62	16.30	16.65
August	15.97	16.46	16.36
September	16.05	16.50	
October	15.98	16.32	
November	15.87	16.31	
December	15.85	16.45	
Average	15.51	16.28	

The increases in the annual average price are as follows:

1954 over 1953	1955 over 1954	1956 over 1955	1957 over 1956	1958 over 1957	1959 over 1958	1960 over 1959	1961 over 1960
10.0%	7.1%	6.6%	6.2%	8.3%	10.0%	8.8%	5.0%

For the twelve months ended August 31, 1962, the increase over the preceding twelve months was 2.5%. The average price was 16.52¢ compared with 16.12¢ in the twelve months ended August 31, 1961.

APPENDIX C

1960 South Louisiana jurisdictional sales by 13 producers at prices above 21.25¢ (Mcf at 15.025 psia)

Producer	From Petitioner's Exhibit D-2 (No. 74, Br. page 42)		As adjusted to deduct non-jurisdictional sales and adjust for sales subject to refund		As adjusted to reflect 1962 settlements by Shell, Ohio, and Tidewater and to reflect settlements in certificate proceedings in Docket Nos. G-13169, G-13746 and related dockets	
	Total Mcf 1960	Estimated not subject to refund	Total Mcf 1960	Estimated not subject to refund	Total Mcf 1960	Estimated not subject to refund
Amerada	4,024,376	99,837	4,024,376	99,837	[3] 2,914,449	99,837
Cities Service	6,661,308	1,042,637	6,661,308	1,042,637	[4] 6,631,117	1,042,637
Continental	82,402,402	2,921,393	82,402,402	2,921,393	[5] 75,649,680	2,921,393
Gulf	27,100,259	5,646,958	27,100,259	5,646,958	27,100,259	5,646,958
Hunt Oil	8,892,149	26,199	8,892,149	26,199	8,892,149	26,199
Ohio	7,071,256	0	7,071,256	0	[6] 0	0
Phillips	42,697,022	23,950,166	42,697,022	[7] 4,723,411	[8] 37,201,986	[7] 4,723,411
Shell	132,882,136	14,009,648	132,882,136	14,009,648	4,753,099	0
Sohio	11,926,080	978,865	11,926,080	978,865	11,926,080	978,865
Sun	34,002,685	18,549,843	[1] 30,323,860	[1] [2] 240,547	30,323,860	240,547
Texaco	50,591,625	47,766,413	[1] 23,793,187	[1] [9] 5,108,791	23,793,187	5,108,791
Tidewater	14,011,377	11,382,513	[1] 11,887,217	[1] [9] 5,809,213	[9] 5,173,711	[9] 5,173,711
Union Producing	13,806,581	8,006,985	[1] 9,433,129	[1] 3,633,533	9,433,129	3,633,533
Total 13 producers	436,069,256	134,381,457	399,094,381	44,241,032	243,792,706	29,595,882
Total all producers	[10] 1,128,327,240		1,057,063,532		936,050,600	

[1] Sales of 36,974,875 Mcf to Humble Gas Transmission Co., (formerly Olin Gas Transmission Corp.) have been excluded because they are intrastate. Most of these (31,851,952 Mcf) are so shown at pages 102-3 of the Form 2 report relied on by petitioner. The remaining sales have been so identified by a letter from Humble in answer to our inquiry made to ascertain the facts. The sales are by the following producers in the amounts shown:

	Volume (Mcf)
Sun	3,678,825
Texaco	26,798,438
Tidewater	2,124,160
Union Producing	4,373,452
Total	36,974,875

[9] Sun's FPC Gas Rate Schedule No. 114 covers a sale of gas to United Gas Pipe Line Company as to which the Commission's issuance of a permanent certificate in Docket No. G-15122 was set aside and remanded in *United Gas Improvement Company* v. *F.P.C.*, 290 F. 2d 147 (C.A. 5), certiorari denied, 366 U.S. 596. On the remand, United Gas Improvement Company, which is one of the

Eastern Seaboard Companies, petitioners in No. 74 in this Court, has argued that the Commission has authority to require refunds (UGI brief, August 13, 1962, Docket Nos. G-13183, et al.) The Commission, in an order dated June 14, 1962, errata notice dated June 28, 1962, in *H. L. Hunt*, et al., Docket Nos. R162-467, et al., agreed. It described Sun's Rate Schedule No. 114 as being in effect subject to refund. Sun has actually made a settlement proposal involving a substantial refund. We therefore have eliminated volumes under Rate Schedule No. 114 from the "Not Subject to Refund" Column. Volumes sold under Rate Schedule No. 114 in 1960 were 14,630,471 Mcf.

[3] The Form 2 report of United Fuel Gas Co., relied on by petitioner, fails to list FPC rate schedule numbers applicable to certain of its purchases from the Erath field, South Louisiana. Petitioner therefore assumed that these purchases are not subject to refund. We have ascertained the numbers by letter from United Fuel Gas Co. Phillips Schedule No. 273 and Texaco No. 6 are both subject to refund. Tidewater No. 26 was the subject of a settlement which reduced the price below 21.25¢ as to approximately 40% of the gas sold under this schedule. *Tidwater Oil Co.*, Docket No. 13310, et al., order issued June 15, 1962. We have therefore adjusted petitioner's table with respect to these Erath Field sales as follows:

Producer	R.S. No.	Volume, Mcf	Not subject to refund
Phillips	273	16,707,861	.....
Texaco	6	15,858,184	.....
Tidewater	26	8,622,851	5,173,711
	.....	41,189,896	5,173,711

[4] Southern Natural Gas Co., Phillips Petroleum Co., Joint Venture Rate Schedule No. 1 covers a sale of gas to Transcontinental Gas Pipe Line Co. The related certificate application, Docket No. G-17444, was consolidated with the Texaco-Seaboard certificate proceedings, Docket G-13169, order dated January 10, 1962. That order provided for refunds "to the extent, if any, that the rate which has been collected exceeds the rate ultimately found to accord with the requirements of the public convenience and necessity." Order dated August 24, 1962, in Docket No. G-17444, provided for the calculation of the amount of refund, with interest. The amount of the settlement is to be paid not in cash, but in gas to be made available without further payment over the life of the contract. We have therefore excluded this sale from the "Not Subject to Refund" column.

[5] The Transco-Seaboard settlement reduced the price under certain rate schedules to less than 21.25¢, and the quantities so affected have therefore been excluded. The rate schedule numbers are listed in *Texaco Inc.*, Docket No. G-13169, *et al.*, order dated July 30, 1962 and *Socony-Mobil Oil Co.*, Docket No. G-13746, *et al.*, order dated August 24, 1962. The volumes under each rate schedule are taken from the purchasers' Form 2 reports, and are as follows:

Producer	*Mcf*
Amerada	1,109,927
Cities Service	30,191
Continental	6,752,722
Ohio	1,238,752
Phillips	5,495,036
Tidewater	1,916,319
Total	16,542,947

[6] The "Total All Producers" figure has been adjusted to reflect the adjustments made in sales by the thirteen producers listed in Exhibit D-2. We have not determined what adjustments should be made in this total with respect to sales of other producers.

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